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USAID FOR AFR/EA

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TAGS: ETRD ECON EAID EINV ELAB PREL TBIO KE AGOA
SUBJECT: KENYA HOPES TO SAVE AGOA APPAREL GAINS

REF: NAIROBI 1321 (NOTAL)

¶1. (SBU) SUMMARY: Apparel and garment exports to the United States under AGOA have been one of Kenya's few economic bright spots in recent years. However, faced with new competition stemming from the end of the Multi Fiber Agreement, an estimated 11,000-plus jobs have already been lost. The GOK is hoping that a more flexible wage policy will help keep the factories competitive, but, to date, the details of the new scheme are not clear. Kenyan authorities are also hoping to reinvigorate Kenya's cotton sector, and are looking at biotech as a possible contributor. USAID/REDSO is engaged in a number of regional activities that could benefit Kenya's textile and apparel sector. Despite these efforts, the Gap's recent decision to pull out of Kenya highlights deeper problems to be overcome if Kenya is to be globally competitive. End summary.

KENYA'S GARMENT AND APPAREL INDUSTRY AT RISK

¶2. (U) In the 1970s and 1980s Kenya enjoyed a flourishing textile and clothing industry, but it collapsed in the late 1990s largely due to mismanagement and poor trade policies. In 2000, the African Growth and Opportunity Act (AGOA) paved the way for significant recovery. In 2004, AGOA apparel exports were valued at $US261 million and supported approximately 32,000 jobs. However, as reported in reftel, Kenya's garment industry is fragile, with the vast majority of investment coming from Asian companies that site production facilities globally. The current pressure on Kenya's garment production comes from both the huge increases in Asian, mostly Chinese, textile exports, in response to the end of the global Multi Fiber Agreement (MFA) and also from the anticipated end of the "third country" agreement under AGOA in 2007 which permits Kenyan firms to used imported thread and fabric in garments for the U.S. market.

¶3. (U) The USAID-sponsored East and Central Africa Global Competitiveness Hub in Nairobi recently commissioned a study on "The Impact of the End of MFA Quotas on COMESA's Textile and Apparel Exports Under AGOA." The Kenya analysis notes that the creation of a vibrant apparel export sector in a relatively short time span to take advantage of AGOA has been a remarkable achievement for Kenya. With 40 existing companies, a "critical mass" has been achieved and experienced entrepreneurs have been able to put into place quality and compliance systems to satisfy some of the most demanding buyers, including Wal-Mart and JC Penney. The report also notes that the Export Processing Zones Authorities (EPZ) have created a favorable environment for exporting enterprises. However, Kenya faces significant constraints including dependence on third country fabric, relatively high labor costs and low productivity, poor industrial relations, lack of long-term funds, the lack of fiscal incentives to the textile and apparel sectors, a long production cycle (90-120 days), and a weak primary textile industry.

¶4. (U) The report recommends the following GOK actions: 1) introduce fiscal incentives to encourage investment and offset current significant infrastructure disadvantages, particularly transport and energy costs; 2) establish a textile fund to provide long-term financing; 3) strengthen the transport infrastructure from the port of Mombasa to the EPZs. In addition, the report recommends that labor unions play a more constructive role, and that the private sector become more proactive in marketing efforts to identify niche markets and invest in programs to improve labor productivity. The report is available at http://www.ecatradehub.com/reports/rp.2005.01 .impact.end.mf a.quotas01.asp.

¶5. (U) Kenya's Apparel Manufacturers Exporters Association (KAMEA), the Kenya Association of Manufacturers (KAM), and other sources report that at least seven textile companies and over 11,000 jobs have been lost in the sector as since the January end of the MFA. According to KAMEA Chairman Jas

Bedi, there are few new orders for Kenyan factories beyond July, but U.S. buyers remain interested in sourcing from AGOA countries, especially after U.S. action to limit Chinese imports on some categories of apparel. John Akala, EPZA Operations Manager, says the problem has been compounded by the introduction of new system of customs clearance for both exports and imports. Textile exports have recently been delayed up to two weeks at the Port of Mombasa, causing further delays as these consignments miss their shipping assignments.

THE SECTOR CAN BE SAVED -- MAYBE

¶6. (U) In May 2005, the German Development Agency (GTZ) and the World Bank released a draft report "Export Strategy Implementation Action Plan March 2005" outlining actions the GOK should pursue in order to save Kenya's apparel sector. The report noted that the sector needs to take immediate action to reduce costs, "otherwise all benefits accrued from AGOA will fade away." One key proposal from the report is that the GOK should establish one or more competitive textile mills to supply the garment export sector with adequate quality fabric.

¶7. (U) Possibly of more immediate help, the FY05-06 budget proposes changes in Kenya's wage policy to allow export-oriented producers more flexibility in wages, a step long sought by Kenya's garment industry. Finance Minister David Mwiraria acknowledges that Kenya's labor productivity is low, and has been declining since 2000, even as real wages have been increasing. At present, Kenya's average cost for unskilled workers is Ksh 3,420 (about US$45) a month, while that of competing suppliers, China and India, is Ksh 2,660 (about US$35). Mwiraria's proposal would set a minimum wage based on productivity for both private and public sector workers, adjustable every two years. However, it is not clear who would determine the revised wages. Currently, the Productivity Center of Kenya (PCK) lacks the capacity to develop appropriate sectoral productivity indices. Rajeev Arora, General Manager of United Aryan, a textile firm operating one of Kenya's EPZs, is concerned that there is no clarity on who would determine the wages, the industry or government.

¶8. (U) The other pillar of Mwiraria's plan is to revive Kenya's moribund cotton sector. This year's budget allocates KSh 250 million (about $US3.3 million) for improving domestic cotton production and processing. The GOK has already begun confined field trials of genetically modified Bt Cotton, with a view to possible commercial production, though no timeframe is assigned. The GOK is drafting new biotechnology legislation, but does not yet have the regulatory framework in place to allow the commercial cultivation and use of biotech cotton.

USAID/REDSO IS HELPING

¶9. (U) In a project to support existing and new garment manufacturing factories in East and Southern Africa, USAID's Regional Economic Development and Support Office (REDSO), in partnership with the US-Africa Trade and Aid Link, is funding a feasibility study for a proposed Nairobi-based textile training center, the Regional Model Manufacturing and Training Center (RMMTC), which would serve eight AGOA eligible countries: Kenya, Uganda, Tanzania Rwanda, Ethiopia, Malawi, Zambia, and Madagascar. At this time there is no commitment for funding the RMMTC from either donors or African nations, but Kenya's Ministry of Trade and Industry and the EPZA have donated land for the future construction of this facility if it is funded. The idea behind the RMMTC is to provide training and career development for thousands of African workers in "best manufacturing practices." The current project proposal includes the possible establishment of 50 start-up companies with an average of 2,000 RMMTC-trained employees each.

¶10. (U) In April, the REDSO-funded Regional Agricultural Trade Expansion Support (RATES) program held an inaugural regional cotton and textile executive summit earlier this year in Nairobi at which 150 representatives from 20 African countries attended. The major outcome of summit was the unanimous agreement by industry executives to form a regional African cotton and textile industry body, an initiative that was endorsed by COMESA and the East African Community (EAC). At a subsequent steering committee meeting held in Johannesburg, industry executives agreed on the formation of the "African Cotton & Textile Industries Federation" (ACTIF), representing the full value chain from cotton production to apparel. Its activities will focus on global trade initiatives; investment and finance; inter-regional trade and production; ginning and lint trade issues. RATES is the interim secretariat. Additional information can be found at www.cottonafrica.com.

THE GAP LEAVES KENYA BUT APPRECIATES AGOA

¶11. (SBU) Efforts to prop-up Kenya's apparel and garment sector did not stop the U.S. retail giant, Gap, Inc., from ending its relationship with contract producers in Kenya. On July 19, Wayne Mann (please protect), Gap's Sub-Saharan Africa Vendor Compliance Manager, informed Acting Economic Counselor that Gap would no longer contract in Kenya, where, according to Mann, the majority of garment factories do not meet the company's standards for working conditions and labor relations. Kenya's well-know infrastructure and security problems, and the inefficient Port of Mombassa also played a role in the company's decision. Employee productivity was not a negative, according to Mann, who viewed the workers' manual dexterity and work ethic to be globally competitive. [Note: According to November 2004 report jointly by the World Bank and Kenya Institute of Public Policy Research and Analysis (KIPPRA), a median Kenyan worker turns over US$3,457 of manufactured value added per annum compared to US$3,400 from India and US$4,400 for China respectively. End note.] However, most Kenyan apparel companies -- in fact the majority are recent investments from India -- were using outdated equipment and had very poor personnel management. Since 2003, Gap has assessed 16 factories in Kenya, and only 7 met the company's minimum requirements for productivity and business practices. (Gap's global average for factory approval is around 95 percent.) Gap has never contracted a large portion of its production in Kenya, less than one percent of its global contracts, and used only four or five factories in total, and just one currently. The company was surprised, however, that Kenya could not compete, given its long history of garment manufacturing.

¶12. (SBU) Mann requested that any public discussion of the Gap's decision should be limited to its official explanation for its Kenya exit: "Gap has been carefully evaluating the ability of our vendors and their sourcing markets to meet our scale, speed and efficiency requirements. Given that we have only had sporadic production in Kenya over the past two years and currently only have one approved factory in Kenya, we have come to the conclusion that Kenya does not meet our long term sourcing needs."

¶13. (SBU) Despite Gap's departure from Kenya, Mann is optimistic about the apparel sector in parts of Africa, particularly Lesotho, Madagascar, and South Africa. In reaction to the end of the MFA, Gap is planning to pursue "long-term," (that is, 4-5 year) partnerships with a select group of suppliers. Gap believes that with AGOA preferences, factories in Africa can compete globally as long as they focus on sound business practices, including progressive labor relations.

COMMENT

¶14. (SBU) It is unlikely that Kenya's feeble labor unions will object much to any reasonable GOK plan on wage flexibility, especially in the Export Processing Zones. As the Gap case highlights, however, Kenya's biggest difficulties as a globally-competitive apparel producer are bigger than marginally reduced wages. As Ambassador Bellamy and other Mission officials frequently point out to GOK interlocutors, Kenya's problem is with the basics of its business climate: poor roads, telecommunications, and electricity, growing security concerns, and inefficient import/export practices. Likewise, the Kibaki administration's planned investments to revive the cotton sector face a range of hurdles, including a history of failure to be competitive in cotton growing and ginning. It is not obvious that Kenya has a competitive or comparative advantage in cotton production vis--vis other countries in the region, particularly with high quality cotton available from Ethiopia, Uganda and Tanzania. Opening up to regional competencies in the cotton sector is Kenya's best hope. As noted in the Trade Hub report Kenya is likely better placed to focus its scarce resources on processing and should rely on raw cotton imports from its more efficient neighbours.
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